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## Agenda Item 4

September 12, 2011

### TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Annual Review
- II. **PROGRAM:** Affiliate Investment Programs

### III. RECOMMENDATION:

1. Approve a one-year renewal of investment manager contracts for:
  - AllianceBernstein US Strategic Value Equity
  - The Boston Company Small Mid Cap Growth Equity
  - The Boston Company Small Mid Cap Value Equity
  - Pyramis Global Advisors Trust Company Select International Equity
  - Turner Investment Partners Core Growth Equity
  - Pacific Investment Management Company (PIMCO) Short-Term Bond
2. Approve interim asset allocation policy targets and benchmarks for the Judges' Retirement System II Fund, the Legislators' Retirement System Fund, the California Employers' Retiree Benefit Trust Fund and the Long-Term Care Fund as shown in Attachment 1.

Wilshire Consulting's opinion letter and disclosure letter are included as Attachments 2 and 3, respectively.

### IV. ANALYSIS:

#### Background

The Affiliate Investment Programs Division (AIPD) has both program and investment management responsibilities. Table 1 below details the Division's primary responsibilities.

**Table 1: Affiliate Investment Programs Division Primary Responsibilities**

<b>CalPERS Program</b>	<b>Plan Type</b>	<b>Plan/Name</b>	<b>AIPD Responsibilities</b>
<b>Supplemental Income Plans ("SIP")</b>	<b>Defined Contribution/Deferred Compensation Plans</b>	CalPERS Supplemental Income 457 Plan	Program & investment management
		Peace Officers' and Firefighters' (POFF) Supplemental Plan	Program & investment management
		Supplemental Contributions Plan	Program & investment management
<b>Affiliate Funds</b>	<b>Defined Benefit Retirement Plans</b>	Legislators' Retirement System (LRS)	Investment management
		Judges' Retirement System (JRS) II	Investment management
	<b>Health Care Funds and Other Post Employment Benefit Plans</b>	CalPERS Long-Term Care (LTC)	Investment management
		Health Care Fund (HCF)	Investment management
		California Employers' Retiree Benefit Trust (CERBT)	Investment management
<b>MHLP</b>	<b>Home Loans</b>	CalPERS Member Home Loan and Secured Personal Loan Programs	Program management

**Affiliate Investment Programs Division Accomplishments for Fiscal Year 2010-11**

This past fiscal year staff have reduced administrative costs, enhanced employer and participant communication, and identified opportunities to enhance selected programs. Accomplishments are further detailed below.

- Developed new asset allocation policies for the LRS, JRS II, LTC and the CERBT funds, in collaboration with the Investment Office Asset Allocation team.

- Created two additional funds for the California Employers' Retiree Benefit Trust (CERBT) Fund to provide greater choice for employers, in collaboration with program staff.
- Introduced and transitioned Supplemental Income Plans participants' assets from the Stable Value Fund into a new Short-Term Investment Fund while rolling out the PIMCO Short-Term Bond fund on August 30, 2010.
- Reduced Supplemental Income Plans administrative and investment management costs by \$411,327. This reduction comes from ING as the record keeper lowering fees to CalPERS and from PIMCO reducing their asset management fees.
- Reduced participant fees from 98 to 64 basis points for Peace Officers' & Firefighters' (POFF) Supplemental Plan due to sufficient Plan reserves for expenses.
- Piloted a live webcast, "Personal Investment for Retirement" which has been viewed by over 1,000 members, in collaboration with the Public Affairs Office.
- Facilitated a program review of the Member Home Loan Program and the Secured Personal Loan Program resulting in the suspension of the program to new loans.
- Supported the PSR and my|CalPERS project to enhance customer service and online functionality for the Supplemental Income Plans.

### **Supplemental Income Plans Program Management Update**

The Affiliate Investment Program Division manages the programs for the CalPERS Supplemental Income 457 Plan, the POFF Supplemental Plan and the Supplemental Contributions Plan. Program management includes CalPERS staff providing customer service, marketing and oversight of ING as the record keeper. ING's responsibilities also include customer call centers and customer service in collaboration with CalPERS staff.

As of July 31, 2011, CalPERS and ING conducted 4,310 one on one participant meetings at employer sites over the last year. These educational meetings provide information on the investment options in the supplemental plans as well as general information about the pension plan benefits. Marketing of the CalPERS Supplemental 457 Plan has been

suspended to reduce workload and focus resources on the MylCalPERS project. Additional SIP statistics are shown in Charts 1, 2, 3, and 4 below.

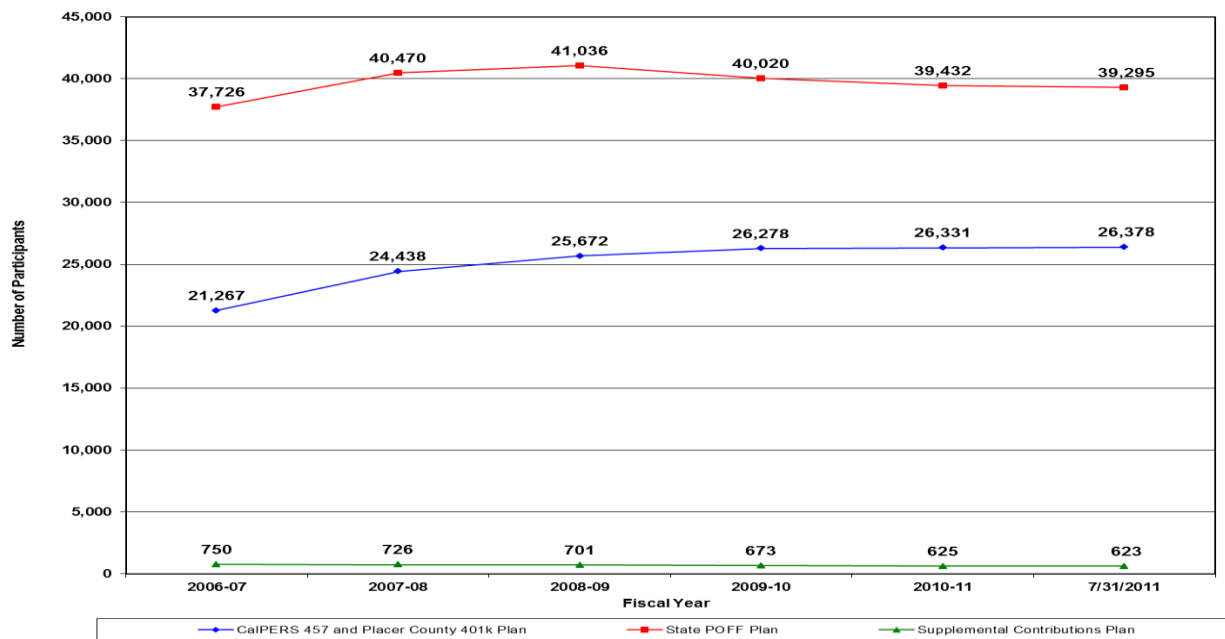
**Chart 1: Plan Participants, Assets Under Management and Average Balances as of July 31, 2011**

Plan Type	# of Participants	Total Assets Under Management	Average Balance per Participant
CalPERS 457 and Placer County 401k Plan	26,378	\$ 942,426,413	\$ 35,728
State POFF Plan	39,295	\$ 487,691,910	\$ 12,411
Supplemental Contributions Plan	623	\$ 19,474,672	\$ 31,260

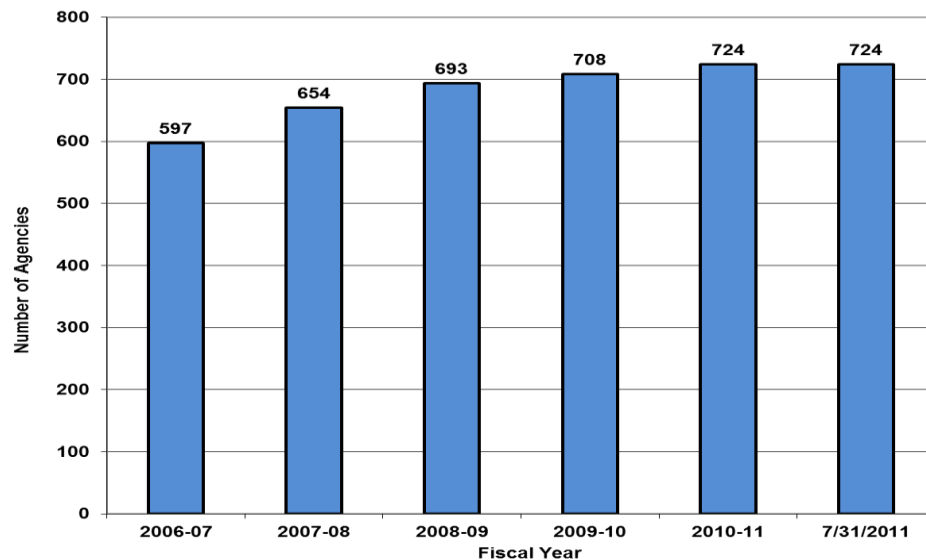
**Chart 2: Supplemental Income Plans Customer Service Statistics - FY 2010-11 through July 31, 2011**

	# of Appointments	# of Presentations	# of Customer Calls	Avg Speed of answer (seconds)	# of Web Visits
All SIP Plans	4,310	314	29,638	30	35,848

**Chart 3: Number of Participants in CalPERS Supplemental Income Plans – FY 2006-07 through July 31, 2011**



**Chart 4: Contracting Agencies in CalPERS Supplemental Income 457 Plan**



Due to the flat participation numbers and the relatively small balances in the Plans, staff intends to reevaluate the SIP program strategy in FY 2011-2012.

### **Supplemental Income Plans Investment Management Update**

The Supplemental Income Plans three separate trust funds have unique fund line-ups and fee structures.

1. The CalPERS Supplemental 457 Plan offers both CalPERS internally managed funds and externally managed funds for a total of 26 funds for participant selection.
  - a. Twelve funds are “core” funds with both passive and active alternatives for participants to select their funds and allocations.
  - b. Three funds are “risk based” asset allocation funds with a conservative, moderate, and aggressive alternative.
  - c. Eleven funds are “target retirement date” asset allocation funds where participants can choose funds based on their expected retirement date.

2. The POFF Supplemental Plan offers the CalPERS moderate asset allocation fund. There is no participant fund direction in this plan since all assets are employer contributions with no employee contributions allowed.
3. The Supplemental Contributions Plan offers the same funds as the Supplemental 457 Plan for participant selection.

Please see Table 2 on the next page for Supplemental Income Plan performance, participant numbers and participant assets for each fund. Performance is shown net of investment management and administrative fees with an average weighted expense of 54 basis points. Benchmark performance is gross of fees.

**Table 2: Supplemental Income Plan Fund Performance and Fees  
(457 and POFF Plan Net Returns %, Period Ending 7/31/11)**

<b>CORE FUNDS</b>	<b>Combined Plan Participants</b>	<b>Combined Plan Assets (\$000)</b>	<b>1 Year</b>	<b>Annualized 3 Years</b>	<b>Annualized 5 Years</b>	<b>Annualized Fund ITD</b>	<b>Inception Date</b>	<b>Fees</b>
SSgA STIF	8,145	166,850						
BofA/ML 3-Mo U.S. T-Bill (benchmark)			0.1	0.4	1.9	-0.1	9/1/10	0.50% **
PIMCO SHORT-TERM BOND *	200	5,523				0.9	9/1/10	0.55%
BofA/ML 6-Mo U.S. T-Bill (benchmark)			0.5	2.7	4.0	0.3		
CalPERS TOTAL RETURN BOND	4,825	49,981	4.8	6.9		6.0	6/1/07	0.55%
Bardays Capital Aggregate (benchmark)			4.4	7.1	6.6	6.7		
CalPERS TIPS SECURITIES	1,643	29,263	11.1	6.6		7.9	6/1/07	0.55%
Bardays Capital US TIPS (benchmark)			11.8	6.8	7.4	8.3		
CalPERS S&P 500 EQUITY INDEX	9,397	142,655	19.3	2.8	2.3	7.7	2/1/95	0.35%
S&P 500 (benchmark)			19.7	2.9	2.4	8.3		
ALLIANCE BERNSTEIN LARGE CAP VALUE *	710	4,463	13.9	1.5		-5.2	6/1/07	0.90%
Russell 1000 Value (benchmark)			16.8	1.3	0.0	-4.6		
TURNER LARGE CAP GROWTH *	4,606	45,312	22.3	1.5		-1.6	6/1/07	0.90%
Russell 1000 Growth (benchmark)			24.8	5.3	5.5	1.5		
CalPERS SMALL/MID EQUITY INDEX	8,149	119,790	24.8	6.2		0.2	6/1/07	0.40%
Russell 2500 (benchmark)			25.2	6.5	5.1	0.6		
THE BOSTON COMPANY SMID GROWTH *	536	5,347	31.2			22.9	12/1/08	0.98%
Russell 2500 Growth (benchmark)			30.4	7.2	6.9	30.5		
THE BOSTON COMPANY SMID VALUE *	369	2,388	15.5			18.8	12/1/08	0.98%
Russell 2500 Value (benchmark)			20.6	5.9	3.0	22.6		
CalPERS INTERNATIONAL INDEX	1,806	16,320	18.1	-0.5		-3.3	6/1/07	0.40%
FTSE Dev World Index ex US (benchmark)			18.7	0.2	2.5	-2.6		
PYRAMIS SELECT INTERNATIONAL *	4,652	34,152	20.3			18.0	12/1/08	0.94%
FTSE Dev World ex US/EAFE Linked (benchmark)			18.7	-0.6		18.9		
<b>RISK-BASED FUNDS</b>								
CalPERS CONSERVATIVE ALLOCATION	2,408	34,583	9.7			10.4	12/1/08	0.64%
SIP Conservative Policy (benchmark)			10.1	5.4	5.6	11.8		
CalPERS MODERATE ALLOCATION	6,748	122,892	14.9			15.1	12/1/08	0.64%
SIP Moderate Policy (benchmark)			15.4	3.8	4.3	16.0		
CalPERS AGGRESSIVE ALLOCATION	4,287	50,322	19.1			19.3	12/1/08	0.64%
SIP Aggressive Policy (benchmark)			19.5	2.3	3.3	19.8		
<b>TARGET RETIREMENT FUNDS</b>								
CalPERS TARGET RETIREMENT INCOME	363	9,707	9.7			10.4	12/1/08	0.64%
SIP Income Policy (benchmark)			10.1	5.4	5.6	11.8		
CalPERS TARGET RETIREMENT 2005	73	1,146	11.3			12.0	12/1/08	0.64%
SIP 2005 Policy (benchmark)			11.9	4.8	5.0	13.6		
CalPERS TARGET RETIREMENT 2010	529	14,973	12.6			13.0	12/1/08	0.64%
SIP 2010 Policy (benchmark)			13.1	4.7	4.8	14.4		
CalPERS TARGET RETIREMENT 2015	672	17,357	13.7			14.3	12/1/08	0.64%
SIP 2015 Policy (benchmark)			14.3	4.3	4.7	15.4		
CalPERS TARGET RETIREMENT 2020	1,338	23,948	14.8			15.4	12/1/08	0.64%
SIP 2020 Policy (benchmark)			15.3	3.5	4.1	16.4		
CalPERS TARGET RETIREMENT 2025	494	8,759	16.5			16.5	12/1/08	0.64%
SIP 2025 Policy (benchmark)			16.8	2.9	3.6	17.3		
CalPERS TARGET RETIREMENT 2030	1,237	14,481	17.7			18.0	12/1/08	0.64%
SIP 2030 Policy (benchmark)			18.0	2.4	3.3	18.6		
CalPERS TARGET RETIREMENT 2035	398	3,007	18.9			18.9	12/1/08	0.64%
SIP 2035 Policy (benchmark)			19.3	2.2	3.3	19.7		
CalPERS TARGET RETIREMENT 2040	924	7,806	19.1			19.2	12/1/08	0.64%
SIP 2040 Policy (benchmark)			19.5	2.3	3.3	19.8		
CalPERS TARGET RETIREMENT 2045	142	691	19.1			19.0	12/1/08	0.64%
SIP 2045 Policy (benchmark)			19.5	2.3	3.3	19.8		
CalPERS TARGET RETIREMENT 2050	65	440	19.0			19.4	12/1/08	0.64%
SIP 2050 Policy (benchmark)			19.5	2.3	3.3	19.8		
<b>PEACE OFFICERS &amp; FIRE FIGHTERS</b>								
PEACE OFFICERS & FIRE FIGHTERS (POFF) FUND	39,295	395,787	14.9	3.5	3.3	2.9	7/1/99	0.64%
SIP Moderate Policy POFF (benchmark)			15.4	4.6	4.4	4.2		

\*\*In addition, the Fund may be charged an annual custody fee and such other fees and expenses as are permitted by the Declaration of Trust.  
Returns shown are net of investment management and plan level expenses. Benchmarks are shown gross of any fees.

For the one year period ending July 31, 2011, the Supplemental Income Plans' passive funds have performed as expected while the active funds have had varied performance.

### **Notable Outperformance**

- CalPERS Total Return Bond fund outperformed its benchmark by 38 basis points net of fees for the one-year period.
- PIMCO Short-Term Bond fund became available to plan participants on August 30, 2010 and has outperformed its benchmark since inception by 65 basis points net of fees.
- Pyramis international equity fund outperformed its benchmark by 160 basis points net of fees.
- The Boston Company small/mid-capitalization (SMID) growth equity fund outperformed by 84 basis points net of fees.

### **Notable Underperformance**

- AllianceBernstein large capitalization equity fund continues to struggle with underperformance of 290 basis points net of fees over one year but with outperformance in the three year period.
- The Boston Company small/mid-capitalization (SMID) value equity fund underperformed by 516 basis points net of fees.

### **Mixed Performance**

- The 14 asset allocation (risk-based and target retirement date) funds underperformed net of fees while all funds outperformed on a gross of fees basis. Within their peer universes, the asset allocation funds had an above median average ranking.

With many of the funds approaching a three year track record and relatively small participation in both assets and participants for some funds, staff is reviewing the fund line-up and will recommend to the Investment Committee changes in early 2012. Recommendations may include active investment manager changes, updates to the asset allocation fund underlying asset classes, and/or a reduction in the number of funds offered. Accordingly staff is recommending a renewal of all external manager contracts for a one year basis.



### **Affiliate Funds Investment Management Update**

Table 3 below shows performance for the affiliate funds. Performance is net of investment management fees while the benchmark is gross of fees.

**Table 3: Affiliate Funds Performance Summary Report  
(Net Returns %, Period Ending 7/31/11)**

	Assets (\$000)	1 Year	Annualized 3 Years	Annualized 5 Years	Annualized Fund ITD	Inception Date
LEGISLATORS' RETIREMENT SYSTEM FUND	123,427	12.7	7.3	6.3	9.0	7/1/88
LRS Policy (benchmark)		12.4	6.6	6.0	9.1	
JUDGES' RETIREMENT SYSTEM II FUND	568,854	15.2	4.9	4.4	6.4	12/1/96
JRS II Policy (benchmark)		15.1	4.9	4.5	6.5	
LONG-TERM CARE FUND	3,295,234	14.9	6.2	5.4	7.2	3/1/96
LTC Policy (benchmark)		14.5	5.9	5.3	7.1	
CalPERS HEALTH CARE BOND FUND	461,405	5.3	7.5		6.2	5/1/07
Barclays Capital Aggregate (benchmark)		4.4	7.1		6.4	
CalPERS EMPLOYERS' RETIREE BENEFIT TRUST FUND	1,869,941	16.8	3.8		1.1	6/1/07
CERBT Policy (benchmark)		16.6	4.1		0.4	

All the funds outperformed over the last year, with longer term performance closely tracking their benchmarks. The CERBT fund performance had a since inception outperformance and a three year underperformance due primarily to large cash flows creating return volatility. Cash flow processes have improved significantly to reduce portfolio risks.

For the LRS, JRS II, LTC and the CERBT funds, the CalPERS Investment Committee approved new asset allocations policies on August 15, 2011. Staff has begun moving the funds to the new asset allocation targets and benchmarks with the goal of minimizing transaction costs and market impact. The funds and the benchmarks will be at the new policy targets based on the Policy Transition Timeline shown in Attachment 1.

### **Member Home Loan Program and Secured Personal Loan Program**

Management of the Member Home Loan Program and the Secured Personal Loan Program includes the oversight of CitiMortgage as the master servicer of the ten primary servicers. As of June 30, 2011, there are 974 mortgages owned by CalPERS and 4,080 personal loans secured by members' retirement accounts. For the mortgages, loss mitigation is a focus to limit losses to the Public Employees' Retirement Fund while for the personal loans focus is on ensuring members make timely payments

to limit retirement benefit losses. Table 4 below shows statistics of the 83 loss mitigation packages issued through June 30, 2011.

**Table 4: Member Home Loan Program Loss Mitigation Initiatives and Results as of June 30, 2011**

Modifications		
Approved 11	Denied 16	In Review 20
Short Sales		
Approved 5	Denied 5	In Review 1
Repayment Plans		
Approved 1	Denied 0	In Review 7
Loss Mitigation Packages Issued with No Response		
17		

#### **Affiliate Investment Programs Division Initiatives for Fiscal Year 2011-12**

The Affiliate Investment Programs Division has several initiatives in Fiscal Year 2011-12 with a continued focus to reduce cost, enhance customer service, and maintain investment returns, including:

- Transition LRS, JRS II, LTC and CERBT to their new policy asset allocations with minimal costs and impact on fund performance.
- Introduce two new CERBT funds for employer choice, in coordination with program staff.
- Strategic review of the Supplemental Income Plans program and investment fund line-up with recommendations to the Investment Committee in early 2012.
- Implement a new CalPERS Supplemental Income 457 Plan EZ Enrollment Form - a simplified enrollment process to encourage enrollment and savings. Under the EZ Enrollment process, participants complete a simplified enrollment form and receive information regarding their investment options. Participants can make their own investment elections using the voice response or online systems within a short period after enrollment. Participants' accounts will be invested in the appropriate Target Retirement Date

Fund as the “default” only if the participant does not make an affirmative investment election.

- Reduce POFF Supplemental Plan fees from 64 to 55 basis points due to sufficient Plan reserves for expenses.
- Implement my|CalPERS with enhanced employer and member services and reporting.
- Extending the contract with ING to provide continuous program recordkeeping and system enhancements during the implementation of the my|CalPERS project. With this contract extension, Supplemental Income Plan costs will be reduced further by \$240,000 which is a 7 percent reduction from 2010-11.
- Review the Health Care Fund (HCF) investment strategy and recommend an investment policy to the Investment Committee for approval.

### **Recommendations**

1. Approve staff recommendations for one-year contract renewals for:
  - \* AllianceBernstein US Strategic Value Equity
  - \* The Boston Company Small Mid Cap Growth Equity
  - \* The Boston Company Small Mid Cap Value Equity
  - \* Pyramis Global Advisors Trust Company Select International Equity
  - \* Turner Investment Partners Core Growth Equity
  - \* Pacific Investment Management Company (PIMCO) Short-Term Bond

External investment manager contracts have one-year renewable extensions without termination dates, contingent upon Investment Committee approval. CalPERS can terminate these agreements upon 30 days' notice.

The SSgA STIF management contract is under the custody contract with State Street Bank which does not require an annual renewal. SSgA STIF is an investment option offered in the CalPERS Supplemental Income 457 Plan and the Supplemental Contribution Plan.

2. Approve interim asset allocation policy targets and benchmarks for the LRS, JRS II, LTC and the CERBT funds as shown in Attachment 1.

#### **VI. STRATEGIC PLAN:**

This item is consistent with initiatives addressing multiple CalPERS Strategic Plan Goals including:

- Goal VI to administer pension benefit services in a customer oriented and cost effective manner.
- Goal VII to enable and educate members and employers to make informed decisions leading to a predictable and secure retirement future.
- Goal IX to achieve long-term, sustainable, risk adjusted returns.

#### **VII. RESULTS/COSTS:**

The affiliate funds are self-sustaining trust funds. There are no additional costs for the trust funds associated with this agenda item.

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Members of the Investment Committee  
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Chief Investment Officer